A **TUNKU DATO' SRI ISKANDAR TUNKU ABDULLAH**

v.

AHMAD KAMIL ABDULLAH & ORS

B HIGH COURT MALAYA, KUALA LUMPUR
BALIA YUSOF WAHI J
[CIVIL SUIT NO: S7-22-847-2003]
30 JULY 2009

C ***TORT:*** *Negligence - Causation - Whether there existed a causal link between auditor's negligence and the society's loss - Judgment based on fraud and financial misappropriation obtained against society's office bearers - Whether auditor ought to be liable for the fraud and financial misappropriation of the office bearers - Nature and extent of damages*
D *recoverable by public officer of society - Whether only nominal damages recoverable*

TORT: *Negligence - Duty of care - Auditors - Manner of assessing nature and extent of duty owed by auditors - Standard required of a*
E *reasonably competent auditor exercising the requisite skill and responsibility - Whether for court to decide whether a prima facie breach of duty occurred - Whether defendant failed to discharge its duty in accordance with the standard expected of the discipline*

The plaintiff commenced a civil suit against the defendants in his
F capacity as the public officer of the Malaysian Association of Travel and Tour Agents (MATTA). This action was pursued against the third defendant – MATTA's firm of public accountants – for negligence in carrying out the audit of MATTA's account for the year ending 31 December 1997. The plaintiff's claim against
G the other defendants was *inter alia* for conspiracy, fraud and breach of fiduciary duties. The action against these other defendants had been disposed off with judgment against them obtained. The plaintiff claimed that at MATTA's AGM on 27 June 1998, a lot of queries were raised by MATTA's members with
H regard to the accounts. The accounts were not approved. Instead members voted to hold an EGM within six months to enable the third defendant to prepare a fresh set/statement of accounts. The EGM was held on 28 November 1998 and more queries were raised by the members in respect of the accounts.
I The members then appointed an Investigative Committee ('IC'). Subsequently, a firm of Public Accountants ('BDO') was engaged to conduct an investigative audit on the accounts. Both the IC's

and BDO's reports later revealed that certain material transactions were not reflected in the statement of the accounts, and there were also unrecorded banking transactions and unrecorded bank accounts. In short there were a lot of discrepancies and shortcomings in the statement of accounts prepared by the third defendant.

Held (allowing the plaintiff's claim):

(1) From the available evidence, it was very clear that the IC Report and the BDO Report disclosed a lot discrepancies and shortcomings in the audited accounts of MATTA prepared by the third defendant. It was also clear that it was only after the meeting with the investigative committee that the third defendant started going into the details of MATTA's accounts and dealing with the banks. (para 8)

(2) In deciding whether the third defendant had breached its duty of care, its conduct must be looked at in the light of the circumstances known to it at the material time. The standard of reasonable care must be objectively assessed on the basis of knowledge reasonably available to it and all the measures that could have been reasonably adopted at the material time. *JSI Shipping (s) Pte Ltd v. Teofoongwonglcloong (a firm)* (CA) (refd). (para 9)

(3) In the instant case, as a reasonably competent auditor exercising the requisite skill and responsibility, with a healthy degree of professional scepticism, the third defendant's suspicion should have been aroused when it realised that insufficient documents and information were given by MATTA. Calling for documents and information and probing into them constituted an integral part of an auditor's duty in preparing the accounts of an entity. Furthermore having been an accountant for MATTA since 1981, the third defendant would surely have been more than familiar with the books and accounts and the income of MATTA. Surprisingly the third defendant was content with what it had and did nothing about it. Relying solely on what was supplied by the treasurer and without making any attempt to raise even a single query on the matter was certainly an indication of either incompetence or carelessness. It was part and parcel of the third defendant's duty to make inquiries and investigation in preparing the audited accounts of MATTA, which on the

A evidence, the third defendant failed to do. If at all there were inquiries and investigations made, it was only after the rejection of the accounts at the AGM and the EGM held on 27 June 1998 and 28 November 1998 respectively. *Re Kingston Cotton Mills Company (No. 2)* (foll). (paras 9 & 10)

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(4) It is for the court to decide whether on the facts and circumstances, a *prima facie* case of breach of duty has occurred. In the instant case, the third defendant had indeed failed to discharge its duty in accordance with the standard C expected of the discipline. The third defendant had failed to make enquiries and investigations and had failed to exercise reasonable care and skill in preparing the audited accounts of MATTA. The third defendant had not demonstrated what a reasonably competent auditor would have done under the D circumstances of the case. The plaintiff had proven his case against the third defendant. The third defendant was negligent. *Gaelic Inns Pte Ltd v. Patrick Lee PAC* (refd); *Pacific Acceptance Corporation Ltd v. Forsyth* (refd). (paras 11 & 12)

E **(5)** The burden of proof was on the plaintiff to establish that the third defendant's act or omission caused MATTA's loss. For the third defendant to be liable for the loss or damages suffered by the plaintiff, it had to be shown that such loss suffered was attributable to the third defendant's negligence or F breach of duty. The court had to decide whether there was a causal link between the breach of duty and the loss claimed. *JSI Shipping (s) Pte. Ltd. v. Teofoongwonglcloong (a firm)* (CA) (refd). (para 13)

(6) In the instant case, judgment had been obtained against all G the other defendants and the basis of the claim against them was the fraudulent misappropriation of the funds belonging to MATTA. Thus whatever losses that MATTA suffered was caused by the fraudulent acts of the other defendants and was not attributable to the third defendant's negligence. The third H defendant should not be liable for the fraud committed by the others. (para 14)

(7) The loss suffered and claimed by the plaintiff was not the kind of loss which was attributable to the breach of duty and the I negligence of the third defendant in its carrying out of the audit work. There was no causal link between that loss and

the third defendant's breach of duty. In the circumstances, the said loss/damage suffered by the plaintiff was not claimable from the third defendant. However, for the negligence of the third defendant, nominal damages and costs ought to be awarded to the plaintiff. (paras 15, 16 & 17)

Case(s) referred to:
Bell v. Peter Browne & Co [1990] 2 QB 495 ***(refd)***
Gaelic Inns Pte Ltd v. Patrick Lee PAC [2007] 2 SLR 146 ***(refd)***
JSI Shipping (s) Pte Ltd v. Teofoongwonglcloong (a firm) [2007] 4 SLR 460 ***(refd)***
Nelson Guarantee Corporation Ltd Hodgson and Others [1958] N1LR 609 ***(refd)***
Pacific Acceptance Corporation Ltd v. Forsyth [1970] 92 WN (NSW) 29 ***(refd)***
Re Kingston Cotton Mills Company (No 2) [1896] 2 Ch 279 ***(foll)***
South Australia Asset Management Corporation v. York Montague Ltd [1997] AC 91 ***(refd)***
Sutherland Shire Council v. Heyman [1935] 60 ALR 1 ***(refd)***

Legislation referred to:
Societies Act 1966, s. 7

For the plaintiff - R Vinayaga; M/s Skrine & Co
For the 3rd defendant - Izleen Ismail (Kevin Sathiaseelan with her); M/s Syed Alwi Ng & Co

Reported by Andrew Christopher Simon

JUDGMENT

Balia Yusof Wahi J:

[1] In this suit, the plaintiff is claiming for the reliefs mentioned hereunder against the third defendant only. The plaintiff's claims against the rest of the defendants named in the suit have been disposed off and judgments have been obtained. The plaintiff brings the suit in his capacity as the public officer of the Malaysian Association of Travel and Tour Agents (MATTA), a society duly formed under s. 7 of the Societies Act 1966. The third defendant is a firm of public accountants. The reliefs sought by the plaintiff against the third defendant are as follows:

(i) judgment for the sum of RM2,952,415.61;

(ii) further or in the alternative; damages to be assessed;

(iii) interest thereon at the rate 8% per annum from the date of judgment to the date of full settlement;

(iv) costs on a solicitor-client basis;

(v) such other or further orders as this Honourable Court thinks fit.

The Evidence

[2] The claim of the plaintiff against the third defendant is premised on the negligence of the third defendant in carrying out the audit of the society's account for the year ending 31 December 1997. The plaintiff called its only witness who was the President of the society for the year 1998/1999. At the Annual General Meeting of MATTA held on 27 June 1998, a lot of queries were raised by the members with regard to the account and it was not approved. At the said meeting the third defendant's representative, Mr Chew was present and informed the meeting that if the members required a project by project account, a special account would be prepared. Besides that, Mr Chew merely highlighted that if the accounts are not approved by the AGM, a penalty for late submission to the Inland Revenue Department will be imposed. It is to be noted that the due date for submission was in May but was extended to the end of June 1998. There was no indication whatsoever what the third defendant would do in response to all the queries raised by the members. The AGM concluded that an Extraordinary General Meeting would be held within six months to enable the accountant to re table the accounts.

[3] The Extraordinary General Meeting was held on 28 November 1998 and again Mr. Chew was present. More queries were raised by the members at the said EGM and still not answered. The accounts were again not approved and an investigative committee was set up as proposed by the members. Subsequently the investigative committee in its report disclosed that certain material transactions were not reflected in the financial statement of the accounts. Resulting from that the Management Committee of MATTA engaged the services of BDO Binder, a firm of Public Accountants to conduct investigative audit on the accounts. The BDO Binder report discovered unrecorded banking transactions and unrecorded bank accounts. There is no evidence to suggest that the third defendant in doing the accounts of MATTA had

conducted that audit based on the books of accounts of MATTA. There were failures of the third defendant to check the book of accounts and to ascertain whether the bank accounts were inactive. The third defendant having done the accounts of MATTA since 1981 should have known and be familiar with the ATF and MITF accounts which constitute the main income of MATTA for the year 1997. These accounts were not available in MATTA's office and yet it raised no suspicion on the part of the third defendant. When queried about this matter at the AGM, the third defendant's agent merely responded by suggesting that if the members required such, a special set of accounts would have to be prepared. The report further stated that MATTA's income for 1997 was understated by approximately RM2,366,522 due to hidden transactions. For the MITF account it was revealed that there was a shortage of RM49,600. In respect of one particular bank account, the HSBC main, the BDO's finding disclosed receipts and payments of unknown nature and not substantiated by supporting documents. The draft audited accounts prepared by the third defendant was issued to one Texas Thong on 21 April 1998 and an unqualified report was issued on 24 April 1998 and it was only withdrawn by the third defendant on 21 December 1998, after the EGM on 28 November 1998. This was after the third defendant had met with the investigative committee. The reason for the withdrawal was stated by the third defendant to be due to the discovery of additional information on the ATF and MITF transactions which were not recorded in the books of accounts of MATTA. The evidence clearly shows that the third defendant despite all the queries raised about the accounts during the AGM did nothing to qualify the report until after the EGM and the findings of the investigative committee.

[4] During cross examination, this witness maintains his evidence in chief and further confirms that MITF has been a regular activity of MATTA since 1991 and there has always been an account for that. At the same time he stated that the third defendant admitted they were not able to verify some of the tickets in MITF indicating that at least the third defendant was at that point of time suspicious or at the very least was aware that something needed to be looked into or probed further. But it did not. The third defendant acknowledged that the ATF and MITF accounts were not available and relied solely on what was supplied by the treasurer and the president. The president of MATTA then

A is the first defendant in this suit. This witness also went further to reiterate that the treasurer of MATTA, the fourth defendant, did suggest during the AGM that there should not be any discussion on the financial statements in order to shorten the meeting.

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[5] What was more revealing during the cross examination of the witness is the disclosure about fraud and conspiracy that was spinning between the rest of the defendants in this suit and hence the filing of this action against the defendants. The pleadings in C encl. 33 list down the allegations of fraud and conspiracy and misappropriation of monies against the first, second, fourth, fifth and sixth defendants.

[6] The third defendant did not call any witness and offered no D evidence. The court was informed that the defendant's witness was not available because he was on sabbatical leave and was on the way to becoming a monk.

[7] It is trite that when a party offers no evidence, the court must ascertain whether from the evidence adduced by the other E party a case has been made out. Of course the court must also consider the cross examination of the witness and see whether the evidence as it stands is sufficient and capable of establishing the party's case.

F **[8]** From the evidence available before me, it is very clear that the Investigative Committee Report and the BDO Binder Report disclosed a lot discrepancies and shortcomings in the audited accounts of the society prepared by the third defendant. It is also clear that it was only after the meeting with the investigative G committee that the third defendant started going into the details of the MATTA's account and dealing with the bank. In his submissions, learned counsel for the third defendant contends that unlike the investigative audit conducted by BDO Binder, the third defendant is only doing a normal audit and therefore the standard H to be adopted is lower and submits that the audit was done based on and in accordance with the International Auditing Guidelines A121 and the Auditing Standards A1560, issued by the Malaysian Institute of Accountants. Counsel for the third defendant also submits that the audit was carried out based on I the documents given by the treasurer of the society and that some of the accounts were not in the books of the society. Counsel submits that the third defendant has not breached its duty as an auditor.

[9] In my judgment, in deciding whether the third defendant has breached its duty of care, its conduct must be looked at in the light of the circumstances known to it at the material time and the standard of reasonable care must be objectively assessed on the basis of knowledge reasonably available to it and all the measures that could have been reasonably adopted at the material time. (*JSI Shipping (s) Pte. Ltd. v. Teofoongwonglcloong (a firm)* [2007] 4 SLR 460). In my view, as a reasonably competent auditor exercising the requisite skill and responsibility, with a healthy degree of professional scepticism, the third defendant's suspicion should have been aroused when it realised that insufficient documents and information were given by the society. Calling for documents and information and probing into them is an integral part of an auditor's duty in preparing the accounts of an entity. Furthermore having been an accountant for the society since 1981 surely the third defendant would have been more than familiar with the books and accounts and the income of the society. Surprisingly the third defendant was content with what it had and did nothing about it. Relying solely on what was supplied by the treasurer and without making any attempt to raise even a single query on the matter is certainly an indication of either incompetence or carelessness. In *Re Kingston Cotton Mills Company (No. 2)* [1896] 2 Ch. 279 @ p. 288, Lopes J stated:

> It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care, and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful.

It is part and parcel of the third defendant's duty to make inquiries and investigation in preparing the audited accounts of the society. Mc Carthy J of the Supreme Court, Wellington in *Nelson Guarantee Corporation Ltd. Hodgson and Others* [1958] N1LR 609 stated:

A The primary purpose in the engagement of an auditor is to obtain a report to the shareholders on the accounts of the company, and the primary duty of the auditor is to make that report.

In carrying out this primary duty, an auditor has to exercise reasonable care and skill in making inquiries and investigations, which may include investigations and reports upon the conduct of employees of the company.

[10] On the evidence before me, I find this to be lacking on the third defendant. If at all there were inquiries and investigations made, it was after the rejection of the accounts after the AGM and the EGM held on 27 June 1998 and 28 November 1998 respectively.

[11] On the issue of compliance with auditing standards, certainly the adherence to the approved accounting standards has a better chance of defending criticisms in the conduct of the audit as compared to an auditor who departs from them. However, ultimately it is the court that decides whatever on the facts and circumstances of the case, a *prima facie* case of breach of duty has occurred (*Gaelic Inns Pte. Ltd. v. Patrick Lee PAC* [2007] 2 SLR 146). Perhaps it is worth noting the observations of Moffitt J in *Pacific Acceptance Corporation Ltd v. Forsyth* [1970] 92 WN (NSW) 29 at p. 75 which says:

When the conduct of an auditor is in question in legal proceedings it is not the province of the auditing profession itself to determine what is the legal duty of auditors or to determine what reasonable skill and care requires to be done in a particular case, although what others do or what is usually done is relevant to the question of whether there had been a breach of duty. It follows, if the auditing profession or most of them fail to adopt some step which despite their practice was reasonably required of them, such failure does not cease to be a breach of duty because all or most of them did the same.

[12] Having considered the evidence before me, being the evidence of the plaintiff only, and the circumstances of the case, I say it without hesitation that the third defendant has failed to discharge its duty in accordance with the standard expected of the discipline. The third defendant has failed to make enquiries and investigations and has failed to exercise reasonable care and skill in preparing the audited accounts of the society. The third defendant has not demonstrated what a reasonably competent

auditor would have done under the circumstances of the case. The plaintiff has proven his case against the third defendant and I hold that the third defendant was negligent.

[13] On the issue of damages, let me start by saying that the burden of proof lies on the plaintiff to establish that the third defendant's act or omission, caused the society's loss. It is trite law that a cause of action based on negligence does not accrue until damages is suffered. Hence it is from that date not the date of the negligent act or omission occurred that the cause of action arises (see: *Bell v. Peter Browne & Co* [1990] 2 QB 495). So the critical question is when the damage happened and the burden of proof is on the plaintiff to establish that the third defendant's act or omission caused the society loss. The plaintiff is claiming that as a result of the negligence or breach of duty of the third defendant, the society has suffered loss of RM2,952,415.61 million and further or alternatively is claiming for damages to be assessed. Later in his submissions, learned counsel for the plaintiff submitted that he will be happy to be awarded the specific amount of RM2,952,415.61 being the loss suffered together with interest. For the third defendant to be liable for the loss or damages suffered by the plaintiff, it must be shown that such loss suffered is attributable to the third defendant's negligence or breach of duty. In other words, the court has to decide whether there was a causal link between the breach of duty and the loss claimed (see: *JSI Shipping (s) Pte. Ltd v. Teofoongwonglcloong (a firm)* [2007] 4 SLR 460).

[14] During cross examination of PW1, it was admitted that there was an allegation of fraud against the 1st, 2nd, 4th 5th & 6th defendants. The pleadings of the plaintiff in the Ikatan Pliding encl. 33 claim various sums of money belonging to the society for conspiracy, fraud and breach of fiduciary duties against those other defendants. These other defendants against whom judgment has been obtained were alleged to have misappropriated the funds and have pocketed them and thus causing loss to MATTA. As disclosed from the pleadings of the plaintiff, the claim against the 4th defendant is also for the sum of RM2,952.415.61 the very same amount of loss claimed against the 3rd defendant. The fourth defendant was the treasurer of MATTA and was the one responsible for keeping and maintaining the records and accounts of MATTA. Judgment has been obtained against all these other

A defendants and the basis of the claim against them were the fraudulent misappropriation of the funds belonging to MATTA. In the light of these facts and circumstances, it is my view that whatever losses that MATTA suffers was caused by the fraudulent acts of these other defendants and is not attributable to the third B defendant's negligence. I am in full agreement with the learned counsel's submissions that the third defendant should not be liable for the fraud committed by others. Not all losses suffered by the plaintiff are recoverable. Before one can consider the principle of which one should calculate the damages on which a plaintiff is C entitled to compensation for loss, it is necessary to decide for what kind of loss he is entitled to be compensated.

[15] Lord Hoffman in *South Australia Asset Management Corporation v. York Montague Ltd* [1997] AC 91 at pp. 211-212 stated:

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> A duty of care such as the valuer owes does not however exist in the abstract. A plaintiff who sues for breach of a duty imposed by the law (whether in contract or tort or under statute) must do more than prove that the defendant has failed to comply. He must show that the duty was owed to him and that it was a duty in E respect of the kind of loss which he has suffered. Both of these requirements are illustrated by *Caparo Indsutries Plc. v. Dickman* [1990] 2 AC 605. The auditors' failure to use reasonable care in auditing the company's statutory accounts was a breach of their duty of care. But they were not liable to an outside take-over bidder because, although they were owed a duty of care, it was F in their capacity as members of the company and not in the capacity (which they shared with everyone else) of potential buyers of its shares. Accordingly, the duty which they were owed was not in respect of loss which they might suffer by buying its shares. As Lord Bridge of Harwich said, at p. 627:
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> > it is never sufficient to ask simply whether A owes B a duty of care. It is always necessary to determine the scope of the duty by reference to the kind of damage from which A must take care to save B harmless.
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> H In the present case, there is no dispute that the duty was owed to the lenders. The real question in this case is the kind of loss in respect of which the duty was owed.

[16] In the same vein, Brennan J in *Sutherland Shire Council v. Heyman* [1935] 60 ALR 1 at p. 48 said:

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> The question is always whether the defendant was under a duty to avoid or prevent that damage, but the actual nature of the damage suffered is relevant to the existence and extent of any duty to avoid or prevent it.

[17] Considering the factual matrix of the case, I am of the view that the loss suffered and claimed by the plaintiff is not the kind of loss which is attributable to the breach of duty and the negligence of the third defendant in their carrying out of the audit work. There is no causal link between that loss and the third defendant's breach of duty. In the circumstances, I hold that the said loss/damage suffered by the plaintiff is not claimable from the third defendant. However, for the negligence of the third defendant, I award a nominal damages of RM1 to the plaintiff and costs.